BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 93-670-W/S - ORDER NO. 94-697

JULY 25, 1994

IN RE: Application of Mountain Bay Estates Utility Company, Inc. for Approval of New Rates and Charges for Water and Sewer Customers in its Service Area in South Carolina.	)))))	ORDER DENYING INCREASE IN RATES AND CHARGES

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of the Application of Mountain Bay Estates Utility Company, Inc. (Mountain Bay, the Company or the utility) for approval of a new schedule of rates and charges for its water and sewer customers in Oconee County, South Carolina. The Company's January 26, 1994 Application was filed pursuant to S.C. Code Ann. §58-5-240 (1976), as amended, and R.103-821 of the Commission's Rules of Practice and Procedure.

By letter dated February 25, 1994, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by the Company's Application. The Notice of Filing indicated the nature of the Company's Application and advised all interested parties desiring participation in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise required to directly notify all customers affected by the proposed rates and charges. Petitions to Intervene were filed on behalf of Steven W. Hamm, the

Consumer Advocate for the State of South Carolina (the Consumer Advocate), Bill Lewis (Mr. Lewis), the Foxwood Hills Property Owners Association (the POA), and Ernest Campbell (Mr. Campbell).[1]

The Commission Staff made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The other parties likewise conducted their discovery of Mountain Bay's rate filing.

A public hearing relative to the matters asserted in the Company's Application was held on June 2, 1994, in the Hearing Room of the Commission at 111 Doctor's Circle, Columbia, South Carolina. Pursuant to S.C. Code Ann. §58-3-95 (Supp. 1993), a panel of three Commissioners composed of Commissioners Mitchell, Butler and Bowers was designated to hear and rule on this matter. John F. Beach, Esquire, represented the Company; Carl F. McIntosh, Esquire, and Elliott F. Elam, Esquire, represented the Consumer Advocate; Mr. Lewis appeared pro se; Lowell W. Ross, Esquire, represented the POA; and Gayle B. Nichols, Staff Counsel, represented the Commission Staff. The public hearing was continued until June 24, 1994, at which time the Commission reconvened the hearing in Oconee County.

The Company presented the testimony of David L. Kerr, Vice President of the utility's operations, to explain the services being provided by the Company, the financial statements and accounting adjustments submitted, and the reasons for the requested

1. Mr. Campbell later determined he would participate as a Protestant.

rate increase. The POA presented the testimony of John W. Klingner, a member of the POA, to explain the POA's concerns regarding the proposed rate increase. Neither the Consumer Advocate nor Mr. Lewis presented testimony. The Commission Staff presented the testimony of Robert W. Burgess, Public Utilities Rate Analyst, and D. Joe Maready, Public Utilities Accountant. Numerous Protestants and other public witnesses testified that they opposed the proposed rate increase. At the conclusion of the hearing, the utility, the Consumer Advocate, and the POA filed briefs.

After thorough consideration of the evidence and applicable law, the Commission makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. The Company is a water and sewer utility operating in the Foxwood Hills Subdivision near Westminster, South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 (1976) et seq. Application; Kerr testimony. The Company provides service to 403 water and 401 sewer customers. Hearing Exhibit 6.

2. The Company's present rates and charges were approved by Order No. 77-455, dated July 20, 1977, in Docket No. 77-120-W/S. Hearing Exhibit 5. Until July 1993, the developer of Foxwood Hills, Foxwood Corporation/National American Corporation (the developer), owned all of the stock of the utility. In July 1993, the developer sold all of the stock of the Company to Johnson Properties, Inc., a professional utility company operator which owns and operates more than 125 water and/or sewer utility systems

in the Eastern United States. As part of its agreement to purchase all of the underlying stock of Mountain Bay, Johnson Properties also purchased all of the underlying stock of four other water and/or sewer utilities. Tr. p. 79, lines 9-13; Hearing Exhibit 3. On January 1, 1994, Johnson Properties began charging those rates which had been approved by the Commission in 1977.[2]

3. At present, the Company charges a monthly flat rate of $5.00 for water and $3.00 for sewer service. Mountain Bay proposes to charge a flat rate of $20.00/month/lot for residential water service, $30.00/month/tap for commercial water service, and $10.00/month/RV lot for water service to recreational vehicle lots. For sewer service, the Company proposes to charge $30.00/month/lot for residential service, $35/month/tap for commercial service, and $10.00/month/RV lot for recreational vehicle service.

4. The utility proposes to charge a disconnect/reconnect fee of $50.00 for disconnection/reconnection of water service at the customer's request. Mr. Kerr testified that approximately two hours of physical labor are involved in disconnecting and reconnecting a customer's water service. Tr. p. 97, lines 10-18. The utility proposes to charge a disconnect/reconnect fee of $100.00 where the Company has disconnected/reconnected water service on a delinquent account. Mr. Kerr asserted the additional $50.00 for disconnection/reconnection for a delinquent account is the result of administrative costs in processing disconnection

2. The developer had only charged $5.00 per month for water and sewer service although it was authorized to charge $8.00 per month. According to Mr. Kerr, "the developer's goal [was] to sell lots, rather than to insure that the utility company was a commercially sustainable venture." Tr. p. 52, lines 5-7.

notices. Tr. p. 97, line 22 - p. 98, line 10. The proposed water rates increase Mountain Bay's operating revenues by 220.10%. The proposed sewer rates increase Mountain Bay's operating revenues by 615.30%. Under the utility's proposed rates and charges, the Company's operating revenues would increase by approximately $142,044.00. Hearing Exhibit 6.

5. The Company asserts its "need for substantial rate relief" is the result of three factors. Tr. p. 40, lines 18-19. First, Mountain Bay contends "[t]he most significant factor is that environmental regulation and enforcement has become significantly stricter and more costly since 1977." Tr. p. 40, lines 19-21. However, Mr. Kerr admitted the total amount of expenses from increased regulation was only $8,300.00. Tr. p. 75, lines 10-23. Second, Mountain Bay asserts that the general increase in cost of living expenses over the past 17 years has contributed to the Company's negative earnings. Third, through witness Kerr, the utility admitted that the rates "set by the developer, who was trying to attract purchasers to the resort of Foxwood Hills, they [the rates] may not have been adequate for the utility to operate on its own even in 1977." Tr. p. 40, line 24 - p. 41, line 2.

6. The Company proposes that the appropriate test period in which to consider its requested increase is the twelve-month period ending June 30, 1993. Application. The Commission Staff concurred in using the same test year for its accounting and pro forma adjustments. Hearing Exhibit 7.

7. The Company agreed with all pro forma and accounting adjustments proposed by the Commission Staff. Tr. p. 70, lines

15-24. As noted by Commission Staff witness Maready, Mountain Bay would have a positive operating margin if availability fees were included in the utility's operating revenues. Tr. p. 144, lines 1-4. Mr. Maready agreed that the annual amount of availability fees[3] was approximately the same amount as the utility's proposed rate increase. Tr. p. 147, line 24 - p. 148, line 9.

Mr. Maready testified the utility's ratepayers benefit by either reducing the utility's rate base by the availability fees or recognizing the availability fees as revenues. Mr. Maready testified that the Commission Staff has traditionally deducted availability fees from the utility's rate base. He explained that Mountain Bay currently does not have a rate base; he recommended that availability fees be deducted from any future plant additions. Tr. p. 136, lines 9-16; p. 148, lines 17-23; p. 153, line 24 - p. 154, line 4.

Company witness Kerr testified that under the terms of the purchase agreements with the developer, availability fees are paid by Foxwood Hills lot owners to the developer until such time as the lot owners connect to the utility system. Mr. Kerr stated that the developer reported the collection of availability fees as income on Mountain Bay's books and that the utility adjusted the availability fees off of its books in its rate Application. Tr. p. 54, line 16-22; p. 68, lines 17-20.

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3. Availability fees are approximately $132,000 on an annualized basis. An average of 2200 customers per year are billed $60.00 in water and sewer availability fees. These numbers indicate that the plant capacity substantially exceeds the amount required to serve existing customers. This difference results in current customers paying larger Operations and Maintenance costs.

Mr. Kerr testified that under the terms of the June 28, 1993 contract for the sale of the developer's stock in Mountain Bay, the developer assigned Johnson Properties its contractual right to receive availability fees from Foxwood Hills property owners. However, for twenty-four (24) months after the close of the stock sale, the developer retained the right to unilaterally rescind its assignment of availability fees. Mr. Kerr testified that this contractual provision specifically states as follows:

> 13.7 Lot Enhancement Fee Assignment Twenty-four months from Closing Date, Sellers agree to assign to Buyer all rights to payment of any lot enhancement fee as set forth in contracts identified in Schedule 13.7. Seller shall have the right during such twenty-four (24) months to modify, or terminate such rights on a case-by-case basis, as it shall determine within its sole discretion. Whenever Sellers or any affiliate own any property subject to a lot enhancement fee, then collection of the lot enhancement fee shall be suspended by Mountain Bay. Following the Closing, Seller may, but shall be under no obligation, to include any lot enhancement fee provisions in any lot sales agreement issued after the closing.

Tr. p. 55, line 23 - p. 56, line 15.

Mr. Kerr testified that Mountain Bay had access to and used the revenues of the developer. Tr. p. 98, line 23 - p. 99, line 8. He explained that once the utility was no longer operated as a subsidiary of the developer, the new owner promptly filed for rate relief from this Commission. He further explained that upon transfer of the stock, Johnson Properties immediately began charging the full rate approved by the Commission in 1977. Tr. p. 67, line 20 - p. 68, line 4. Mr. Kerr testified that Mountain Bay has continually lost money and that, during the test year, the utility lost $131,652.15. Tr. p. 68, lines 7-11.

CONCLUSIONS OF LAW

1. The Company is a water and sewer utility providing water and sewer service in its service area in Oconee County, South Carolina. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 et seq. (1976).

2. The Commission concludes that Mountain Bay was not required to obtain this Commission's approval prior to the transfer of its capital stock. 26 S.C. Regs. 103-504 and 704 (1976) provide, in relevant part, as follows:

> No existing public utility supplying sewerage disposal [water] to the public or any ... corporation ... undertaking the ... acquisition of a utility shall hereafter sell, acquire, begin the construction or operation of any utility system ... without first obtaining from the Commission a certificate that the sale or acquisition is in the public interest ...

The Commission finds that these regulations require Commission approval when a utility sells or acquires a utility system through asset transfer. The Commission does not interpret these regulations to require its approval when a utility's stock is sold. Nonetheless, this Commission does have authority to address and consider the subsequent effects of a stock sale on a regulated utility and its customers.

3. A fundamental principle of the ratemaking process is the establishment of an historical test year with the basis for calculating a utility's rate base and, consequently, the validity of the utility's requested rate increase. While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments

for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See, Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984), citing City of Pittsburg v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958); Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978).

4. The Company chose the test year ending June 30, 1993. The Commission Staff used the same test year in calculating its adjustments. The Commission is of the opinion that the test year ending June 30, 1993, is appropriate based on the information available to the Commission and is therefore adopted.

5. The Commission finds that the Company has not justified its need for a general rate increase. The Company could only support $8300 in increased expenses. It is clear to this Commission that the proposed rate increase is not a function of increased operating costs, but rather a function of new ownership and a revised accounting treatment as related to enhancement or availability fees.

6. The Commission concludes that availability fees should be imputed to the utility as operating revenues.[4] Under the terms of its contract with the seller, Johnson Properties will likely receive the availability fees paid by Foxwood Hill lot owners and

4. In Order No. 94-644, July 11, 1994, the Commission stated that although the Commission had not traditionally imputed availability fees as revenues, it recognized that the better policy is to impute availability fees as revenues when such fees are available for the utility's use or when the fees benefit the utility.

thus will benefit from these fees.

7. Further, the Commission concludes it will not allow utility owners to benefit from transactions which are unfair or inequitable to the utility's ratepayers. The testimony from the hearing indicates that since 1977 the developer operated Mountain Bay at a loss and refused to charge even those rates which had been approved by this Commission. As noted by the Company's witness, the developer kept the utility's rates artificially low in order to attract purchasers to the Foxwood Hills subdivision. As stated by the Company's witness, the utility was able to remain viable only because it used the developer's revenues. The revised accounting treatment for the availability fees as proposed by the utility under Johnson Properties no longer makes these funds available to the utility.

The Commission concludes that Johnson Properties would not have bought Mountain Bay unless it either continued to have the use of the availability fees and/or it received a rate increase.[5] Clearly, availability fees were used as consideration in the sale of the utility's stock. The Commission finds that Johnson Properties, owner of a substantial number of water and sewer utilities, fully recognized and contemplated the effect of the contractual provision regarding availability fees on the Company's financial position. The Commission concludes that by arranging the terms of the contract in such a way as to limit the utility's access to revenues, the developer and Johnson Properties utilized

5. The Commission recognizes the proposed rate increase and annualized availability fees are remarkably similar in amount.

the stock transaction to the benefit of Johnson Properties and to the disadvantage of Mountain Bay's ratepayers.

8. Moreover, the Commission finds it would be inequitable to current customers[6] and lot owners who have paid availability fees for years in order to secure access to future utility service not to receive benefit from their payments. Since the utility has no remaining rate base, the Commission does not have the option of reducing the rate base by availability fees. Consequently, the Commission finds that, for the test year, Mountain Bay's operating revenues were $170,616.

9. In light of the fact that the Company conceded it had no objections to the Commission Staff's proposed expense adjustments, the Commission concludes that the Staff's adjustments to the Company's operating expenses are appropriate. Accordingly, the Commission finds that the operating expenses for the Company for the test year under the present rates and after accounting and pro forma adjustments are $164,137.

10. The Company's appropriate total income for return for the test year, after accounting and pro forma adjustments, is $6,583.[7] Based upon the above determinations concerning the accounting and pro forma adjustments to the Company's revenues and expenses, the Commission concludes that the Company's total income for return is as follows:

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6. Although current customers no longer pay availability fees, they paid availability fees prior to their connection to the utility system in order to secure access to the system.

7. This amount includes customer growth of $104.00.

TABLE A
TOTAL INCOME FOR RETURN

Operating Revenues	$170,616
Operating Expenses	164,137
Net Operating Income	6,479
Customer Growth	104
Total Income for Return	6,583

11. Under the guidelines established in the decisions of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission will provide, through regulation, the opportunity for a utility to earn a reasonable level of revenues. As the United States Supreme Court noted in Hope, a utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and . . . that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

12. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rates of a public utility. For a water and sewer utility whose

rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book value in excess of investment, the Commission may decide to use the "operating ratio" and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the net operating income for return by the total operating revenues of the utility. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984). The Commission concludes that it will use the operating margin methodology in this case.

Based on the Company's gross revenues for the test year, after accounting and pro forma adjustments under the presently approved schedules, and the Company's operating expenses for the test year, after accounting and pro forma adjustments and customer growth, the Company's present operating margin is as follows:

TABLE B
OPERATING MARGIN

Operating Revenues	$170,616
Operating Expenses	164,137
Net Operating Income	6,479
Customer Growth	104
Total Income for Return	6,583
Operating Margin (After Interest)	3.86%

13. The Commission is mindful of the standards delineated in the Bluefield, supra, and Hope, supra, decisions and of the need to

balance the respective interests of the Company and of the consumer. Employing the test year proposed by the Company and applying Staff's expense adjustments, agreed to by the utility, the Company is currently earning an operating margin of 3.86%. The Commission finds that an operating margin of 3.86% is fair and reasonable. It allows the Company to recover its expenses, enables the Company to raise funds necessary for the discharge of its duties, and provides the Company's shareholders with an opportunity to earn a return on their investment.

14. The Commission approves a $50.00 disconnect/reconnect fee when a customer requests that water service be disconnected/reconnected. The Commission finds that the testimony of record supports this charge.

The Commission further approves a $50.00 disconnect/reconnect charge when the utility disconnects/reconnects a customer's water service due to a delinquent account. The Commission finds that $50.00 adequately covers the utility's cost in disconnecting/reconnecting service when service has been disconnected/reconnected due to a delinquent account.

15. Based upon the above considerations and reasoning, it is ordered that the rates and charges approved herein and as shown on Appendix A to this Order are approved for service rendered on or after the date of this Order. This rate schedule is deemed to be filed with the Commission pursuant to S.C. Code Ann. §58-5-240 (1976).

16. Should this schedule not be placed in effect until three (3) months from the effective date of this Order, the schedule

shall not be charged without written permission from the Commission.

17. It is further ordered that the Company maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class B water and sewer utilities, as adopted by this Commission.

18. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell
Chairman

ATTEST:

Gary E. Walsh
Deputy Executive Director

(SEAL)

APPENDIX A

MOUNTAIN BAY UTILITY COMPANY, INC.
MR. DAVID A. KERR
10 KINSTON MANOR DR.
WESTMINSTER, S.C. 29693
822-0522

FILED PURSUANT TO DOCKET NO. 93-670-W/S ORDER NO. 94-697
EFFECTIVE DATE: JULY 25, 1994

WATER

Monthly Flat Rate	$ 5.00
Connection Fee (new customer)	$250.00
Disconnect/Reconnect At Customer's Request	$ 50.00
Disconnect/Reconnect For Delinquent Account	$ 50.00

SEWER

Monthly Flat Rate	$ 3.00
Connection Fee (new customer)	$400.00